

FEDERAL RESERVE SYSTEM

12 CFR Part 226

[Regulation Z; Docket No. R-1392]

RIN No. AD 7100-AD54

Truth in Lending

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Final rule; official staff commentary.

SUMMARY: The Board is publishing a final rule to amend Regulation Z, which implements the Truth in Lending Act (TILA). The final rule implements Section 1461 of the recently enacted Dodd-Frank Wall Street Reform and Consumer Protection Act. Section 1461 amends TILA to provide a separate, higher rate threshold for determining when the Board's escrow requirement applies to higher-priced mortgage loans that exceed the maximum principal obligation eligible for purchase by Freddie Mac.

DATES: The final rule is effective on April 1, 2011, for covered loans for which an application is received by a creditor on or after that date.

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SUPPLEMENTARY INFORMATION:

I. Background

A. TILA and Regulation Z

Congress enacted the Truth in Lending Act (TILA) based on findings that economic stability would be enhanced and competition among consumer credit providers would be strengthened by the informed use of credit resulting from consumers' awareness of the cost of credit. One of the purposes of TILA is to provide meaningful disclosure of credit terms, to enable consumers to compare credit terms available in the marketplace more readily and avoid the uninformed use of credit.

TILA's disclosures differ depending on whether credit is an open-end (revolving) plan or a closed-end (installment) loan. TILA also contains procedural and substantive protections for consumers. TILA is implemented by the Board's Regulation Z. An Official Staff Commentary interprets the requirements of Regulation Z. By statute, creditors that follow in good faith Board or official staff interpretations are insulated from civil liability, criminal penalties, and administrative sanction.

In 1994, Congress amended TILA by enacting the Home Ownership and Equity Protection Act (HOEPA). The HOEPA amendments created special substantive protections for consumers obtaining mortgage loans with annual percentage rates (APRs) or total points and fees exceeding prescribed thresholds. In addition, TILA Section 129(l)(2)(A), as added by HOEPA, authorizes the Board to prohibit acts and practices the Board finds to be unfair and deceptive in connection with mortgage loans. 15 U.S.C. 1639(l)(2)(A).

B. The 2008 HOEPA Final Rule

In July of 2008, the Board adopted final rules pursuant to the Board's authority in Section 129(l)(2)(A). 73 FR 44522, July 30, 2008 (2008 HOEPA Final Rule). The 2008 HOEPA Final Rule defined a class of "higher-priced mortgage loans" and prohibited certain lending and servicing practices in connection with such transactions. Among other things, the Board prohibited extending a higher-priced mortgage loan secured by a first lien unless an escrow account is established before consummation for payment of property taxes and premiums for mortgage-related insurance required by the creditor. *See* § 226.35(b)(3).

Under the 2008 HOEPA Final Rule, a higher-priced mortgage loan is a consumer credit transaction secured by the consumer's principal dwelling with an APR that exceeds the average prime offer rate for a comparable transaction, as of the date the transaction's interest rate is set, by 1.5 or more percentage points for loans secured by a first lien, or by 3.5 or more percentage points for loans secured by a subordinate lien. *See* § 226.35(a)(1).

C. The Dodd-Frank Act

On July 21, 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act) was signed into law.¹ Section 1461 of the Dodd-Frank Act creates TILA Section 129D.² TILA Section 129D substantially codifies the requirement in Regulation Z that escrow accounts for taxes and insurance be established for first-lien higher-priced mortgage loans, adopted by the Board as part of the 2008 HOEPA Final Rule. As discussed above, the 2008 HOEPA Final Rule imposed the escrow requirement

¹ Pub. L. No. 111-203, 124 Stat. 1376.

² Pub. L. No. 111-203, § 1461, 124 Stat. 1376, 2178 (to be codified at 15 U.S.C. 1639D).

on first-lien mortgage transactions having an APR that exceeds the average prime offer rate for a comparable transaction by 1.5 or more percentage points. The Dodd-Frank Act incorporates this coverage test in new TILA Section 129D for loans that do not exceed the maximum original principal obligation for a mortgage to be eligible for purchase by Freddie Mac. TILA Section 129D(b)(3)(A) (to be codified at 15 U.S.C. 1639d(b)(3)(A)).

For loans with an original principal obligation that exceeds the applicable Freddie Mac maximum principal obligation, TILA Section 129D requires escrow accounts only if the APR exceeds the applicable average prime offer rate by 2.5 or more percentage points. TILA Section 129D(b)(3)(B) (to be codified at 15 U.S.C. 1639d(b)(3)(B)). The current maximum principal obligation for a mortgage loan to be eligible for purchase in 2011 by Freddie Mac is \$417,000 for a single-family property that is not located in a designated “high-cost” area.³ (Higher limits apply for mortgage loans secured by a property with two to four residential units.) Thus, if the original principal obligation for a mortgage loan secured by a single-family property in such an area is \$415,000, the determination of whether the loan is subject to the escrow requirement in § 226.35(b)(3) would be made using an APR threshold of 1.5 percentage points over the applicable average prime offer rate; by contrast, if the original principal obligation is \$420,000, the determination would be made using a threshold of 2.5 percentage points over the applicable average prime offer rate. Loans that are not eligible for purchase by Freddie Mac because their original principal obligation is too large are widely referred to in the mortgage market as “jumbo” mortgages. The term “jumbo” also is used in this final rule to refer to such loans.

³ See FREDDIE MAC, BULLETIN NO. 2010-28, 2011 LOAN LIMITS, *available at* <http://www.freddiemac.com/sell/guide/bulletins/pdf/bl11028.pdf>.

II. The Board's September 2010 Escrow Proposal

A. Summary of the September 2010 Escrow Proposal

On September 24, 2010, the Board published a proposed rule in the **Federal Register** to implement TILA Section 129D(b)(3)(B), as enacted by Section 1461 of the Dodd-Frank Act. *See* 75 FR 58505 (September 2010 Escrow Proposal). Accordingly, the Board proposed to raise the rate threshold for coverage by the escrow account requirement for first-lien, higher-priced “jumbo” mortgage loans. Specifically, the Board proposed to require escrows for “jumbo” loans whose APR exceeds the average prime offer rate for a comparable transaction, as of the date the transaction’s interest rate is set, by 2.5 or more percentage points. The Board did not propose to implement other provisions of the Dodd-Frank Act related to escrow accounts under the September 2010 Escrow Proposal. The Board is proposing rules to implement other escrow-related provisions of the Dodd-Frank Act in a separate notice published elsewhere in today’s **Federal Register**.

B. Overview of Comments Received

The comment period on the September 2010 Escrow Proposal closed on October 25, 2010. The Board received 15 comment letters in response to the proposed rule, from creditors, loan originators, banking trade associations, and state banking regulators. No comments were received from consumers or consumer advocates. Commenters generally supported the proposed increase in the coverage threshold for the escrow requirement, for “jumbo” loans.

Several commenters, however, requested that the Board clarify that only the dollar amount specified in the sixth sentence of Section 305(a)(2) of the Federal Home

Loan Mortgage Corporation Act (FHLMCA), 12 U.S.C. 1454(a)(2), should be used in determining whether or not a loan is a “jumbo” loan. (Currently, the amount specified in that sentence as the maximum principal obligation for a loan secured by a single-family residence is \$417,000.) In particular, these commenters stated that the higher maximum principal obligation set for “high-cost” areas under Section 305(a)(2) should not be considered in determining whether a loan is a “jumbo” loan. For example, if the maximum principal obligation eligible for purchase by Freddie Mac in a particular “high-cost” area were \$500,000 for a single-family residence, these commenters believe that a loan with a principal obligation between \$417,000 and \$500,000 secured by a single-family residence in that area should be classified as a “jumbo” loan subject to the higher rate threshold for classification as a higher-priced mortgage loan, even though Freddie Mac may purchase that loan.

Other commenters recommended exemptions from the escrow requirement for higher-priced mortgage loans. Recommended exemptions included for: (1) loans a creditor holds in portfolio; (2) loans made by community banks; (3) loans made in rural areas; and (4) small retail loans that are first-lien loans because a consumer has paid off his larger mortgage. Such exceptions are outside the scope of this rulemaking. The Board is publishing elsewhere in today’s **Federal Register** a proposed rule that addresses several of those proposed exceptions.

III. Summary of the Final Rule

This final rule revises § 226.35(b)(3), as proposed, to provide a higher APR threshold for determining whether “jumbo” mortgage loans secured by a first lien on a consumer’s principal dwelling are higher-priced mortgage loans for which an escrow

account must be established. As revised, the threshold for coverage of the escrow requirement for “jumbo” loans is 2.5 percentage points (rather than 1.5 percentage points) in excess of the average prime offer rate for a comparable transaction, as of the date the transaction’s rate is set. Raising the APR threshold applicable to “jumbo” loans eliminates the mandatory escrow requirement for loans with an APR above the existing threshold but below the new threshold. Creditors may, at their option, elect to continue to use the 1.5 percentage point threshold for “jumbo” loans. Section 226.35 and this final rule do not apply to open-end credit plans subject to § 226.5b or to loans to finance the initial construction of a dwelling, temporary or “bridge” loans with a term of 12 months or less, or reverse mortgages. *See* § 226.35(a)(3). This final rule is effective on April 1, 2011 for covered loans for which an application is received on or after that date, as discussed in detail below in **Part VI** of this **Supplementary Information**.

IV. Legal Authority

The Board amends § 226.35(b)(3) pursuant to its authority under TILA Section 105(a) to prescribe regulations to carry out the purposes of TILA and to provide for such requirements, adjustments, and exceptions as necessary or proper to effectuate the purposes of, to prevent circumvention of, and facilitate compliance with TILA, as discussed in detail below. *See* 15 U.S.C. 1604(a) (as revised).

V. Section-by-Section Analysis

Section 226.1 Authority, Purpose, Coverage, Organization, Enforcement and Liability

1(d) Organization

Section 226.1(d) describes how Regulation Z is organized. Section 226.1(d)(5) describes Subpart E of Regulation Z, which this interim final rule amends by revising

§ 226.35(a)(1) and (b)(3)(v). Comment 1(d)(5)-1 is revised to add a new subpart 1(d)(5)-1.iii, stating that this final rule is effective on April 1, 2011, for covered transactions for which an application is received on or after April 1, 2011.

Section 226.35 Prohibited Acts or Practices in Connection With Higher-Priced Mortgage Loans

35(a) Higher-Priced Mortgage Loans

35(a)(1)

As discussed below, the Board revises § 226.35(b)(3) to provide a higher threshold for determining whether escrow accounts must be established for certain closed-end mortgage loans secured by a first lien on the consumer's principal dwelling, pursuant to the Dodd-Frank Act. As revised, the threshold for coverage of the escrow requirement for "jumbo" loans is 2.5 percentage points (rather than the 1.5 percentage points generally applicable under § 226.35(a)(1)) in excess of the average prime offer rate for a comparable transaction, as of the date the transaction's rate is set. The Board is making a conforming amendment to § 226.35(a)(1) to reflect this exception to the general coverage test for higher-priced mortgage loans.

35(b) Rules for Higher-Priced Mortgage Loans

35(b)(3) Escrows

35(b)(3)(v) "Jumbo" Loans

The Board adds a new § 226.35(b)(3)(v) to implement TILA Section 129D(b)(3)(B), as enacted by Section 1461 of the Dodd-Frank Act. Section 226.35(b)(3)(v) provides a higher threshold for determining whether escrow accounts must be established for certain closed-end mortgage loans secured by a first lien

on a consumer's principal dwelling. Currently, under § 226.35(a)(1), such a loan is considered a higher-priced mortgage loan and is subject to the escrow requirement if its APR exceeds the average prime offer rate for a comparable transaction, as of the date the transaction's rate is set, by 1.5 or more percentage points. Pursuant to TILA Section 129D(b)(3)(B), for a closed-end, first-lien mortgage loan whose original principal obligation exceeds the current maximum principal obligation for loans eligible for purchase by Freddie Mac, the applicable rate threshold is 2.5 percentage points or more above the average prime offer rate for a comparable transaction, as of the date the transaction's rate is set.

Comment 35(b)(3)(v)-1 clarifies that adjustments to the maximum principal obligation that are made by the Federal Housing Finance Agency (FHFA) pursuant to FHLMCA Section 305(a)(2) or by other federal law will apply in determining whether a mortgage loan is a "jumbo" loan subject to the higher APR threshold under § 226.35(b)(3)(v). Comment 35(b)(3)(v)-2 clarifies that the higher APR threshold applies solely in determining if a "jumbo" loan is subject to the escrow requirement. The determination of whether "jumbo" first-lien loans are subject to the other protections in § 226.35, such as the ability to repay requirements under § 226.35(b)(1) and the restrictions on prepayment penalties under § 226.35(b)(2), would continue to be based on the 1.5 percentage point threshold.

Adjustments pursuant to FHLMCA Section 305(a)(2). TILA Section 129D(b)(3)(B) provides that a separate, higher APR threshold applies to a first-lien mortgage loan that exceeds the applicable maximum principal obligation eligible for purchase by Freddie Mac, established pursuant to the sixth sentence of FHLMCA Section

305(a)(2) (the “general maximum principal obligation”). However, the sixth sentence of FHLMCA Section 305(a)(2), as revised by the Housing and Economic Recovery Act of 2008 (HERA), also provides that its principal obligation limitations are subject to other limitations in that paragraph.⁴ *See* 12 U.S.C. 1454(a)(2). Other limitations in that paragraph include annual adjustments based on changes in the housing price index maintained by FHFA and adjustments to increase the maximum principal obligation for loans secured by property in “high-cost” areas. *See* 12 U.S.C. 1454(a)(2). The plain language of the sixth sentence of FHLMCA Section 305(a)(2) incorporates by reference limitations set by other sentences in Section 305(a)(2). The Board believes, therefore, that adjustments made pursuant to Section 305(a)(2) should apply in determining whether a loan is a “jumbo” loan subject to the higher APR threshold for classification as a higher-priced mortgage loan.

The Board believes this is also consistent with statutory intent, because taking into account adjustments to the maximum principal obligation will ensure similar treatment of all loans eligible for purchase by Freddie Mac. The higher threshold for “jumbo” loans reflects the higher price typically associated with loans that are not eligible for purchase by Freddie Mac (or by Fannie Mae, which is subject to the same limit on the maximum principal obligation). Using the higher APR threshold for loans that are eligible for purchase by Freddie Mac after adjustments to the maximum principal obligation pursuant to FHLMCA Section 305(a)(2) would not be consistent with the statutory intent.

⁴ Section 1124 of HERA revises Section 305(a)(2) of the FHLMCA. *See* Public Law 110-289, 122 Stat. 2654, 2692.

Adjustments pursuant to other federal law. Legislation enacted by Congress in 2009 and 2010 provides for further adjustments to the maximum principal obligation eligible for purchase by Freddie Mac. In light of declines in home values in certain areas, Congress provided in that legislation that the maximum principal obligation eligible for purchase by Freddie Mac shall be the greater of: (1) the maximum principal obligation determined pursuant to FHLMCA Section 305(a)(2); and (2) the maximum principal obligation established for 2008 under Section 201 of the Economic Stimulus Act of 2008.⁵ The Board believes such adjustments also should apply in determining if a loan is a “jumbo” loan for purposes of § 226.35(b)(3)(v). The Board believes such adjustments are made pursuant to Section 305(a)(2), because they incorporate FHLMCA Section 305(a)(2) in the formula used to determine the maximum principal obligation eligible for purchase by Freddie Mac.

Nevertheless, even if the adjustments made pursuant to this legislation are not deemed to be made pursuant to Section 305(a)(2), the Board believes it is appropriate to use its authority under TILA Section 105(a) to require consideration of such adjustments. 15 U.S.C. 1604(a). TILA Section 105(a) authorizes the Board to provide for such requirements, adjustments, and exceptions for all or any class of transactions as in the Board’s judgment are necessary or proper to effectuate the purposes of, to prevent circumvention or evasion of, or to facilitate compliance with TILA. The Board believes it is necessary and proper, to effectuate the purposes of TILA Section 129D(b)(3)(B), to make adjustments consistent with the provisions of federal law other than FHLMCA Section 305(a)(2) to ensure all loans eligible for purchase by Freddie Mac are treated

⁵ See Pub. L. 111-242, § 146, 124 Stat. 2607, 2615 (2010) (providing for adjustments under a continuing resolution); Pub. L. 111-88, § 167, 122 Stat. 2904, 2973 (2009) (same); *see also* Pub. L. 110-185, § 201, 122 Stat. 613, 620 (Feb. 13, 2008) (providing for adjustments under the Economic Stimulus Act).

similarly for purposes of the escrow requirements. Further, considering the additional adjustments made by other federal laws is consistent with the language in TILA Section 129D(b)(3)(B), which states that the determination of whether or not a loan is a “jumbo” loan subject to a higher APR threshold shall be based on the maximum principal obligation “in effect” for Freddie Mac as of the date the transaction’s rate is set. The maximum principal obligation in effect is the obligation FHFA establishes pursuant to both FHLMCA Section 305(a)(2) and other federal law.

The Board also believes those adjustments are necessary and proper to facilitate compliance with TILA Section 129D(b)(3)(B). Considering only adjustments made under FHLMCA Section 305(a)(2) would require creditors that sell loans to Freddie Mac to use one dollar limit to ascertain what rate threshold to apply in determining whether a loan is subject to the escrow requirements and a different limit to determine whether they may sell loans to Freddie Mac. The same burden would apply for creditors that sell loans to Fannie Mae, which is subject to the same maximum principal obligation limits. Considering adjustments under both FHLMCA Section 305(a)(2) and other applicable federal law would facilitate compliance by eliminating that burden.

For the reasons discussed above, and pursuant to its authority under TILA Section 105(a), the final rule provides that FHFA’s adjustments to the general maximum principal obligation stated in FHLMCA Section 305(a)(2) which are made pursuant to other applicable federal law shall be considered in determining whether a loan is a “jumbo” loan subject to § 226.35(b)(3)(v). *See* comment 35(b)(3)(v)-1.

VI. Effective Date of Final Rule

The Board is changing the escrow requirement's coverage threshold to implement the statutory amendment made by the Dodd-Frank Act, as discussed above. The amendment relieves mortgage creditors of compliance with the escrow requirement for certain "jumbo" loans. When relief is granted from Regulation Z's escrow requirement, the affected loans could become subject to any state or local laws that prohibit mandatory escrow accounts. As a result, some creditors might need time to make the system changes necessary to comply with state or local laws. Accordingly, the Board sought comment on the amount of time necessary for creditors to implement the change in their systems and procedures.

Almost all commenters that discussed the implementation period stated that the Board should allow creditors to immediately use the higher APR threshold for classification of a "jumbo loan" as a higher-priced mortgage loan. One banking trade association stated that creditors easily can adjust their systems to stop escrowing for such loans. Most of the commenters that addressed the effective date stated that compliance with the higher threshold should be optional until final rules are issued to implement other escrow-related requirements under the Dodd-Frank Act. Those commenters stated that creditors would prefer to adjust their training and systems to implement all escrow-related statutory and regulatory requirements at one time. Some of those commenters stated that, at a minimum, compliance should be optional for a period of time; the recommended periods ranged between six months and one year. An industry trade association and a bank stated that the effective date for the final rule should be delayed until other escrow-related requirements are implemented. The industry trade association

suggested, in the alternative, at least a six-month delay. The industry trade association also stated that creditors should not have to adjust their systems to comply with state or local laws prohibiting mandatory escrow accounts and again subsequently to comply with Board regulations.

The Dodd-Frank Act does not provide an effective date specifically for rules implementing TILA Section 129D(b)(3)(B). The Riegle Community Development and Regulatory Improvement Act of 1994 requires that agency regulations that impose additional reporting, disclosure, and other requirements on insured depository institutions take effect on the first day of a calendar quarter following publication in final form. 12 U.S.C. 4802(b). Consistent with the Riegle Community Development Act, this final rule is effective on April 1, 2011, for covered loans for which an application is received by a creditor on or after that date. *See* comment 1(d)(5)-1.iii. The Board believes that this time period will afford creditors sufficient time to adjust their systems to eliminate escrow accounts for covered loans to comply with any applicable state or local laws that prohibit requiring an escrow account or imposing other escrow requirements.

Under this final rule, creditors can choose to continue to escrow for “jumbo” loans with an APR below the new threshold (subject to applicable state or local laws). This final rule does not require termination of any existing escrow account.

VII. Paperwork Reduction Act

In accordance with the Paperwork Reduction Act (PRA) of 1995 (44 U.S.C. 3506; 5 CFR Part 1320 Appendix A.1), the Board reviewed the final rule under the authority delegated to the Board by the Office of Management and Budget (OMB). The rule

contains no collections of information under the PRA. *See* 44 U.S. C. 3502(3).

Accordingly, there is no paperwork burden associated with the rule.

VIII. Final Regulatory Flexibility Analysis

In accordance with Section 4 of the Regulatory Flexibility Act (RFA), 5 U.S.C. 604, the Board is publishing a final regulatory flexibility analysis for the amendments to Regulation Z. The RFA generally requires an agency to assess the impact a rule is expected to have on small entities. The RFA requires an agency either to provide a final regulatory flexibility analysis with a final rule or certify that the final rule will not have a significant economic impact on a substantial number of small entities. Under standards the Small Business Administration (SBA) sets, the threshold for an entity to be considered “small” is \$175 million or less in assets for banks and other depository institutions and \$7 million or less in revenues for non-bank mortgage lenders.⁶

A. Statement of the Need for, and Objectives of, the Final Rule

Congress enacted TILA based on findings that economic stability would be enhanced and competition among consumer credit providers would be strengthened by the informed use of credit resulting from consumers’ awareness of the cost of credit. Congress enacted HOEPA in 1994 as an amendment to TILA. TILA is implemented by the Board’s Regulation Z. HOEPA imposed additional substantive protections on certain high-cost mortgage transactions. HOEPA also charged the Board with prohibiting acts or practices in connection with mortgage loans that are unfair, deceptive, or designed to evade the purposes of HOEPA, and acts or practices in connection with refinancing of mortgage loans that are associated with abusive lending or are otherwise not in the interest of borrowers. The Board adopted the requirement to establish an escrow account

⁶ 13 CFR 121.201.

for higher-priced mortgage loans under 2008 HOEPA Final Rule pursuant to this mandate.

The Dodd-Frank Act amended TILA to increase the threshold for coverage of the escrow requirement, for certain loans ineligible for purchase by Freddie Mac because their original principal obligation is too high (“jumbo” loans), as discussed above in the **Supplementary Information**. This final rule implements that change by amending Regulation Z. These amendments are made in furtherance of the Board’s responsibility to prescribe regulations to carry out the purposes of TILA. The legal basis for the final rule is in Section 105(a) of TILA. 15 U.S.C. 1604(a).

B. Summary of Significant Issues Raised by Comments in Response to the Initial Regulatory Flexibility Analysis

In accordance with Section 3(a) of the RFA, 5 U.S.C. 603(a), the Board prepared an initial regulatory flexibility analysis (IRFA) in connection with the proposed rule. The IRFA stated that the Board believed the proposed rule would not have a significant economic effect on a substantial number of small entities. The Board requested comment on the IRFA and on any costs, compliance requirements, or changes in operating procedures arising from the application of the proposed rule to small businesses.

No commenter specifically addressed the Board’s IRFA, but several commenters stated that compliance with recent statutory and regulatory changes to requirements for mortgage lending, including amendments to TILA and Regulation Z, is burdensome in the aggregate. Most commenters that discussed the effective date stated that creditors should be able to use the higher annual percentage rate threshold immediately, to provide relief in connection with “jumbo” loans that would be subject to the higher threshold for

the escrow requirement. Those commenters generally recommended, however, that compliance with the final rule be optional until the Board implements other escrow-related requirements under the Dodd-Frank Act. An industry trade association and a bank opposed an immediate effective date for the final rule. Both commenters that recommended allowing creditors to use the higher threshold immediately and commenters that recommended delaying the effective date of the rule suggested that, at a minimum, the Board make compliance optional for a period of time. Recommended periods ranged from 6 months to one year.

As discussed above in **Part VI** of the **Supplementary Information**, the Board believes that the effective date of April 1, 2011, provides sufficient time for creditors to adjust their training and systems to apply the higher APR threshold for “jumbo” loans. The rule is effective on that date for loans where the creditor receives an application on or after April 1, 2011. Escrow accounts typically are established when the loan is consummated some time after the application is processed and approved. Further, creditors can choose to continue to escrow for “jumbo” loans with an APR below the new threshold, subject to applicable state or local laws prohibiting mandatory escrow or imposing other escrow requirements. If a creditor elects not to apply the higher APR threshold to such loans, it is likely that few or no training or systems changes will be necessary.

C. Description and Estimate of Small Entities to Which the Final Rule Applies

The final rule applies to all institutions and entities that engage in closed-end lending secured by a consumer’s principal dwelling. TILA and Regulation Z have broad applicability to individuals and businesses that originate even small numbers of home-

secured loans. *See* § 226.1(c)(1). Using data from Reports of Condition and Income (Call Reports) of depository institutions and certain subsidiaries of banks and bank holding companies and data reported under the Home Mortgage Disclosure Act (HMDA), the Board can estimate the approximate number of small entities that would be subject to the rules. For the majority of HMDA respondents that are not depository institutions, however, exact revenue information is not available.

Based on the best information available, the Board makes the following estimate of small entities that are affected by this final rule: According to September 2010 Call Report data, approximately 8,669 small depository institutions would be subject to the rule. Approximately 15,627 depository institutions in the United States filed Call Report data, approximately 10,993 of which had total domestic assets of \$175 million or less and thus were considered small entities for purposes of the RFA. Of the 3,788 banks, 507 thrifts, 6,632 credit unions, and 66 branches of foreign banks that filed Call Report data and were considered small entities, 3,667 banks, 479 thrifts, 4,520 credit unions, and 3 branches of foreign banks, totaling 8,669 institutions, extended mortgage credit. For purposes of this Call Report analysis, thrifts include savings banks, savings and loan entities, co-operative banks and industrial banks. Further, 1,303 non-depository institutions (independent mortgage companies, subsidiaries of a depository institution, or affiliates of a bank holding company) filed HMDA reports in 2010 for 2009 lending activities. Based on the small volume of lending activity reported by these institutions, most are likely to be small entities.

D. Reporting, Recordkeeping, and Other Compliance Requirements

The changes to compliance requirements that the final rule makes are described in the **Supplementary Information**. The effect of the revisions to Regulation Z on small entities is minimal because the revisions bring about burden relief; certain mortgage loans that otherwise would be subject to the escrow account requirement in § 226.35(b)(3) are relieved of that requirement. To take advantage of that relief, some small entities will need to modify their home-secured credit origination processes once to implement the revised coverage test. The precise costs to small entities of updating their systems are difficult to predict. These costs will depend on a number of unknown factors, including, among other things, the specifications of the current systems used by such entities to originate mortgage loans and test them for “higher-priced mortgage loan” coverage.

E. Steps Taken to Minimize the Economic Impact on Small Entities

The final rule implements a specific numerical adjustment to an annual percentage rate (APR) threshold mandated by Section 1461 the Dodd-Frank Act for “jumbo” loans, which limits the Board’s flexibility to establish alternative APR thresholds. The higher APR threshold may be used in connection with a “jumbo” loan, that is, a loan with an original principal obligation that exceeds the maximum principal obligation for loans eligible for purchase by Freddie Mac. As discussed above in **Part V** of the **Supplementary Information**, the Board believes that, under the Dodd-Frank Act, loans are “jumbo” loans for purposes of TILA Section 129D if they are “jumbo” loans ineligible for purchase by Freddie Mac because their original principal obligation is too high. Some commenters recommended that the Board construe Section 1461 of the Dodd-Frank Act narrowly to consider only the general maximum principal obligation for

loans eligible for purchase by Freddie Mac, despite the fact that the maximum principal obligation is higher in certain high-cost areas.

The Board is not adopting that suggested alternative. As discussed in greater detail in **Part V** of the **Supplementary Information**, the Board believes that the Dodd-Frank Act requires consideration of adjustments to the general maximum principal obligation made by the Federal Housing Finance Agency (FHFA) pursuant to Section 305(a)(2) of the Federal Home Loan Mortgage Corporation Act (FHLMCA). Further, the Board believes that it is necessary to consider additional adjustments FHFA makes pursuant to other applicable federal law to effectuate the purposes of and facilitate compliance with TILA, as discussed above.

List of Subjects in 12 CFR Part 226

Advertising, Consumer protection, Federal Reserve System, Mortgages, Reporting and recordkeeping requirements, Truth in lending.

Authority and Issuance

For the reasons set forth in the preamble, the Board amends Regulation Z, 12 CFR Part 226, as set forth below:

PART 226—TRUTH IN LENDING

(REGULATION Z)

1. The authority citation for part 226 is revised to read as follows:

Authority: 12 U.S.C. 3806; 15 U.S.C. 1604, 1637(c)(5), and 1639(*l*); Pub. L. 111-24 § 2, 123 Stat. 1734; Pub. L. 111-203, 124 Stat. 1376.

2. Section 226.35 is amended by revising paragraph (a)(1) and adding new paragraph (b)(3)(v) to read as follows:

Subpart E—Special Rules for Certain Home Mortgage Transactions

* * * * *

§ 226.35 Prohibited acts or practices in connection with higher-priced mortgage loans.

(a) *Higher-priced mortgage loans*—(1) For purposes of this section, except as provided in paragraph (b)(3)(v) of this section, a higher-priced mortgage loan is a consumer credit transaction secured by the consumer’s principal dwelling with an annual percentage rate that exceeds the average prime offer rate for a comparable transaction as of the date the interest rate is set by 1.5 or more percentage points for loans secured by a first lien on a dwelling, or by 3.5 or more percentage points for loans secured by a subordinate lien on a dwelling.

* * * * *

(b) * * *

(3) * * *

(v) “*Jumbo*” loans. For purposes of this § 226.35(b)(3), for a transaction with a principal obligation at consummation that exceeds the limit in effect as of the date the transaction’s interest rate is set for the maximum principal obligation eligible for purchase by Freddie Mac, the coverage threshold set forth in paragraph (a)(1) of this section for loans secured by a first lien on a dwelling shall be 2.5 or more percentage points greater than the applicable average prime offer rate.

* * * * *

3. In Supplement I to Part 226:

A. Under *Section 226.1—Authority, Purpose, Coverage, Organization, Enforcement and Liability*, new paragraph 1(d)(5)-1.iii is added.

B. Under *Section 226.35—Prohibited Acts or Practices in Connection With Higher-Priced Mortgage Loans, 35(b) Rules for higher-priced mortgage loans, 35(b)(3) Escrows*, new heading *35(b)(3)(v) “Jumbo” loans* and new paragraphs 1 and 2 are added.

SUPPLEMENT I TO PART 226—OFFICIAL STAFF INTERPRETATIONS

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Subpart A—General

Section 226.1—Authority, Purpose, Coverage, Organization, Enforcement and Liability

Paragraph 1(d)(5).

1. *Effective dates.*

i. * * *

ii. * * *

iii. The final rule revising escrow requirements under § 226.35(b)(3) published on **[INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER]** applies to certain closed-end extensions of consumer credit secured by the consumer's principal dwelling. *See* § 226.35(a). Covered transactions for which an application is received by a creditor on or after April 1, 2011 are subject to § 226.35(b)(3), as revised.

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SUBPART E—SPECIAL RULES FOR CERTAIN HOME MORTGAGE TRANSACTIONS

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*Section 226.35—Prohibited Acts or Practices in Connection With Higher-Priced
Mortgage Loans*

* * * * *

35(b) Rules for higher-priced mortgage loans.

* * * * *

35(b)(3) Escrows.

* * * * *

35(b)(3)(v) “Jumbo” loans.

1. *Special threshold for “jumbo” loans.* For purposes of the escrow requirement in § 226.35(b)(3) only, the coverage threshold stated in § 226.35(a)(1) for first-lien loans (1.5 or more percentage points greater than the average prime offer rate) does not apply to a loan with a principal obligation that exceeds the limit in effect as of the date the loan’s rate is set for the maximum principal obligation eligible for purchase by Freddie Mac (“jumbo” loans). The Federal Housing Finance Agency (FHFA) establishes and adjusts the maximum principal obligation pursuant to 12 U.S.C. 1454(a)(2) and other provisions of federal law. Adjustments to the maximum principal obligation made by FHFA apply in determining whether a mortgage loan is a “jumbo” loan to which the separate coverage threshold in § 226.35(b)(3)(v) applies.

2. *Escrow requirements only.* Under § 226.35(b)(3)(v), for “jumbo” loans, the annual percentage rate threshold is 2.5 or more percentage points greater than the average prime offer rate. This threshold applies solely in determining whether a “jumbo” loan is subject to the escrow requirement of § 226.35(b)(3). The determination of whether “jumbo” first-lien loans are subject to the other protections in § 226.35, such as the

ability to repay requirements under § 226.35(b)(1) and the restrictions on prepayment penalties under § 226.35(b)(2), is based on the 1.5 percentage point threshold stated in § 226.35(a)(1).

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By order of the Board of Governors of the Federal Reserve System, February 23, 2011.

Jennifer J. Johnson (signed)

Jennifer J. Johnson
Secretary of the Board.